United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

74-1969-2341-2366

To Be Argued By
ARTHUR A. MUNISTERI

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IIT, an International Investment Trust, and Georges Baden, Jacques Delvaux and Ernest Lecuit, as Liquidators for IIT, an International Investment Trust,

Plaintiffs-Appellees-Cross-Appellants,

v.

VENCAP, LTD., INTERVENT, INC., INTERCAPITAL, N.V., RICHARD C. PISTELL, CHARLES E. MURPHY, JR., DAVID TAYLOR and HAVENS, WANDLESS, STITT & TIGHE,

Defendants-Appellants-Cross-Appellees,

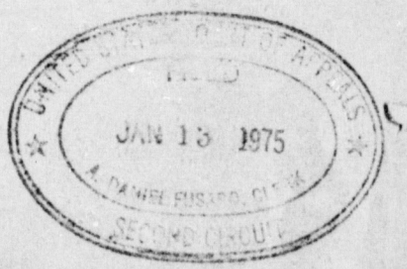
and

WALTER BLACKMAN,

and

ROBERT L. VESCO, MILTON F. MEISSNER, NORMAN LeBLANC and STANLEY GRAZE,

Defendants.



ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF DEFENDANT-APPELLANT-CROSS-APPELLEE
RICHARD C. PISTELL

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UNITED STATES COURT OF APPEALS

For The Second Circuit

Docket Nos. 74-1969, 74-2341, 74-2366

IIT, an International Investment Trust, and Georges Baden, Jacques Delvaux and Ernest Lecuit, as Liquidators for IIT, an International Investment Trust,

Plaintiffs-Appellees-Cross-Appellants,

-against-

Vencap, Ltd., Intervent, Inc., Intercapital, N.V., Richard C. Pistell, Charles E. Murphy, Jr., David Taylor and Havens, Wandless, Stitt & Tighe,

Defendants-Appellants-Cross-Appellees,

and

Walter Blackman,

and

Robert L. Vesco, Milton F. Meissner, Norman LeBlanc and Stanley Graze,

Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF DEFENDANT-APPELLANT-CROSS-APPELLEE RICHARD C. PISTELL

TABLE OF CONTENTS

Page

Table of Authorities

Preliminary Statement

Defendant-Appellant-Cross-Appellee Richard C. Pistell ("Pistell") appeals from an order of the District Court for the Southern District of New York, Charles E. Stewart, Jr., Judge, dated July 3, 1974, granting plaintiffs' motion for a preliminary injunction and for the appointment of a receiver. Judge Stewart's opinion is reproduced at pages 947A through 972A of the Joint Appendix. Plaintiffs brought this action for alleged violations of Section 10(b) of the Securities Exchange Act of 1934 [15 U.S.C. §78j(b)] ("The Exchange Act") and Rule 10b-5 [17 C.F.R. §240.10b-5] promulgated thereunder, as well as for alleged violations of Section 17(a) of the Securities Act of 1933 [15 U.S.C. §77q(a)] ("The Securities Act"). In addition, plaintiffs have stated various pendent claims in the nature of common law fraud and corporate waste.

On June 10, 1974, the plaintiffs commenced this action and moved by Order to Show Cause for a preliminary injunction pursuant to F.R.C.P. 65 and for the appointment of a receiver. On the same day the District Court entered a temporary restraining order enjoining and restraining certain of the defendants from

exercising any control over the present and future assets of IIT, Vencap Ltd. ("Vencap"), Intervent, Inc. ("Intervent") and Intercapital, N.V. ("Intercapital"). Only four days later, on June 14, 1974, an evidentiary hearing commenced with respect to the preliminary injunction motion, now directed only against the corporate defendants and Pistell. Because of the need for expedition, the defendant law firm Havens, Wandless, Stitt & Tighe ("Havens, Wandless"), which had been attorneys for these defendants for several years, represented them at the hearing.

Evidence was taken on six consecutive trial days, through June 21, 1974. On July 3, 1974, the District Court issued an opinion and order enjoining defendants Vencap, Intervent, Intercapital, and Pistell, and those under their control, from exercising any control over the present and future assets of IIT, Vencap, Intervent and Intercapital. In addition, the District Court appointed a receiver to take charge of all present and future assets of IIT, Vencap, Intervent and Intercapital that were in the possession and control of Pistell, Vencap, Intervent and Intercapital.

Pistell brings this appeal pursuant to Title 28, United States Code, Sections 1292(a)(1) and 1292(a)(2) for review of the District Court's order entered July 5, 1974, granting the injunction and appointing a receiver.

Statutes Involved

The following statutes and rules are involved in this appeal:

Section 27 of the Exchange Act [15 U.S.C. §78aa] provides in relevant part:

> The district courts of the United States, * * * shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or to enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or where ever the defendant may be found. * * *

Section 22(a) of the Securities Act [15 U.S.C. §77v] provides in relevant part:

> The district courts of the United States, * * * shall have jurisdiction of offenses and violations under this title and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this title. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process of such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. * * *

28 United States Code, Section 1332 provides:

> (a) The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs and is between-
>
> (1) citizens of different States; foreign states or citizens or subjects thereof; and
>
> (3) citizens of different States and in which foreign states or citizens or subjects thereof are additional parties.
>
> . . .
>
> (c) For the purposes of this section and section 1441 of this title, a corporation shall be deemed a citizen of any

y which it has been incorporated
the State where it has its princi-
ce of business . . .

The word "States", as used in
ction, includes the Territories,
trict of Columbia, and the Common-
of Puerto Rico.

ates Code, Section 1350 provides:

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United States.

ates Code, Section 1337 provides:

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> (2) To obtain money or property by means of any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
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> (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser, in connection with the purchase or sale of any security.

Issues Presented For Review

1. Subject-matter jurisdiction (assuming arguendo all facts found by the district court). Does the Securities Exchange Act of 1934 define the standards of fair dealing, with respect to a purchase and sale of foreign securities, between two foreign corporations where (1) all representations and significant contacts - formal and informal - between the parties took place outside the United States, and (2) the shares of neither foreign corporation were being traded in the United States?

2. Other alleged bases for subject-matter jurisdiction. Assuming that the federal securities laws do not apply to the transaction in question, does the

district court have jurisdiction over plaintiffs' other claims?

3. Sufficiency of Evidence. Do the evidence and findings of fact support the district court's conclusion that plaintiffs are likely to succeed on their securities law claims where there was no evidence or finding of actual non-disclosure or of any causal connection between a supposedly incomplete document and the securities transaction in question?

4. Balance of equities. Assuming that the district court had subject-matter jurisdiction, was it an abuse of discretion to disrupt completely the businesses of Pistell and of the corporate defendants without any evidence (a) that a money judgment would be unsatisfied or, (b) that a waste of assets was imminent?

STATEMENT OF THE CASE

Summary

During 1972, a United States citizen and resident with very substantial business and financial experience (Pistell) favorably impressed one Stanley Graze, a London resident who had over-all supervision of the investments of a Luxembourg investment trust (IIT) that did no business in the United States. In conversations that took place entirely outside the United States, principally in the Bahamas and England, Pistell and Graze agreed (around August 1972) that IIT would invest $3,000,000 in a Bahamian corporation (Vencap) whose prime asset would be Pistell's efforts and personal contacts. IIT would get preference stock, and about one-third of the profits.

In the course of putting the documents together, Vencap's Bahamian lawyers prepared a "three-page memorandum" describing Vencap and its aims. Judge Stewart tentatively concluded (a) that the memo was "false and misleading" under the federal securities laws (A962a)*, (b) that it

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*"A___a" denotes pages in the Joint Appendix; the Record and transcript of proceedings in the district court are contained in volumes 1 and 2; volumes 3 through 9 contain the exhibits introduced into evidence at the hearing.

was part of the inducement leading IIT to part with $3,000,000 (A954a), and (c) that IIT's New York lawyers had prepared a draft of the stock purchase agreement (A954a). According to the district court, the chief deficiency of the memo was its implication that the preference shareholders would get most of the benefits, while the written document signed by plaintiff IIT gave the preference shares a maximum, and preferred dividend of one-third the profits and also contained a redeemability provison disadvantageous to the preferred.

As to (a), it is self-evident, of course, that any discrepancy between the memo and the agreement was necessarily fully disclosed to IIT; with respect to omissions from the memo, the district court made no finding as to whether the omitted information existed at the time (primarily Pistell's intention to borrow from Vencap) or had been supplied to IIT in some other form. As to (b), there was no evidence that the memo actually did induce anyone to do anything. As to (c), the uncontradicted evidence of United States conduct reveals no basis for applying United States law to this foreign transaction.

The Parties

Plaintiffs: IIT is an investment trust organized under Luxembourg law, and the individual plaintiffs are its court-appointed liquidators (A9a, 196a, 286a-87a). In October 1972 IIT purchased 30,000 preference shares of defendant Vencap.

Defendants: For purposes of this appeal, the defendants can conveniently be viewed as falling into four groups:

(1) Three related corporations: Vencap, a Bahamian corporation; Intercapital, a Netherlands Antilles corporation under common control with Vencap and used solely as an intermediary for Vencap for loans to United States persons; and Intervent, a Delaware corporation and wholly-owned subsidiary of Vencap (A10a, 516a-22a, 549a-50a).

(2) Pistell and Blackman, Bahamian residents, American and Bahamian nationals, respectively, who own equal shares of Vencap and Intercapital and control, through Vencap, Intervent (A9a-10a, 549a-50a, 552a-53a, 950a-51a).

(3) Murphy and Taylor are members of the

New York Bar and partners in Havens, Wandless, a New York City law firm that was counsel to Pistell and the corporate defendants.

(4) Individuals formerly in control positions with the "IIT/IOS complex", a group of non-United States investment companies and their management companies, namely, Robert L. Vesco ("Vesco"), Norman LeBlanc ("LeBlanc"), Milton F. Meissner ("Meissner") and Stanley Graze ("Graze") (A10a-11a, 196a-97a, 199a-201a, 696a-97a).

The Complaint

In essence, the complaint alleges that IIT's former managers conspired with Pistell to cause IIT to sell securities owned by it and to appropriate the $3 million proceeds to their own use by means of a sham investment in worthless securities of Vencap. The complaint contains twelve "causes of action", of which three (the first, second and ninth) specifically charge violations of the United States securities statutes. The remaining causes of action are in the nature of common-law fraud, conversion and breach of fiduciary duty, all involving the same transfer of $3 million from IIT to Vencap in 1972. In addition, the complaint charges Pistell and

Blackman with using the funds for their personal benefit, essentially a claim of waste of assets. Although by far the bulk of the evidence concerned the use to which Vencap put its funds in the years following IIT's investment (apparently in fond hopes of tracing some of them to the absent IOS defendants), nevertheless the alleged securities law violations of October 1972 present the only significant issues for this appeal. For only the securities law claims provide even a color of jurisdiction for the federal court, and the district court expressly found that the evidence of waste (considered pursuant to pendent jurisdiction) would not justify the injunction now being challenged (A963a-64a).

Background and Negotiations

In 1972 Richard Pistell, at 44 years of age, had been in the investment and finance business for 24 years. He began his business career as a financial analyst and investment banker on Wall Street as a very young man, had eventually formed his own firms, and had participated in the initial underwriting for such substantial companies as the Mary Carter Paint Company, Capital Cities Television, and Occidental Petroleum. He had also served on

the boards of directors of several publicly held corporations.

In 1972 he was Chairman of the Executive Committee of the Board of Directors of Lincoln American Corporation, which was listed on the American Stock Exchange (A694-95a, 703a, 708a, 1768a).

Early in 1972 Pistell was in the Bahamas on a matter unrelated to the present action when he met Stanley Graze, a former teacher of economics who had a management or advisory position with one or more of the investment funds being managed by the IOS Complex. He and Graze developed a rapport and saw each other, casually, over the next few months in both the Bahamas and in London, England, where Graze lived and had his office.

During their meetings Pistell and Graze casually discussed their views of economics in general, and particularly with respect to money markets and to the question of whether international monetary parity could be maintained. In one of these conversations in London, Graze asked for Pistell's opinion with respect to some of the investments that had been made in the past by the funds which Graze was managing. Graze also asked for

Pistell's comments on Graze's intention to liquidate some of the funds' investments in the event that the Dow Jones average dropped below 1,040. Pistell replied in substance that if he were in Graze's position, he would recommend investment in Japanese Yen, Deutsch Marks and gold, because he predicted (correctly, as it turned out) that there would be further currency devaluations and a resulting increase in the world price for gold (A696a-98a, 701a, 735a, 1305a-08a, 1821a-23a-3889a, 3894a-95a). It appears that from April 1972, through October 1972 plaintiff IIT, one of Graze's funds, had net sales in United States securities of $121,703,019, but there is no indication that these sales were the result of Pistell's suggestions or even that Pistell was aware of them (A593a, 4046a-103a).

During the early part of 1972, Pistell decided to incorporate a venture capital company in the Bahamas, as a convenient vehicle for utilizing Pistell's extensive experience in locating and financing new ventures. He mentioned this plan of his to many individuals including Graze, and in June 1972 Pistell took the first steps to form such a corporation by contacting his long-time

American attorney, Murphy, who was then in Nassau, where he had a home. Murphy arranged for Bahamian counsel, the firm of Carson, Lawson & Co. ("Carson Lawson") to do the necessary work, and Vencap was formed by them on June 30, 1972. At that time Vencap had only ordinary shares of stock, which were held equally by Pistell and a long-time friend of his, Count Amoury de Riencourt, a French national (A694a-96a, 708a, 1364a-66a, 1448a-57a, 1817a-18a, 552a, 675a-76a, 1194a, 1236a, 1275a, 1367a).

The Purchase and Sale of Securities

During conversations between Pistell and Graze in both the Bahamas and London, Graze indicated that one of the funds he advised might well be interested in investing in Pistell's newly-formed corporation. At some point during August 1972 Pistell and Graze agreed in principle upon the terms of the investment. On August 31, 1972, there was an Extraordinary General Meeting of Vencap in Nassau, at which the corporation authorized the issuance of the preference shares which Graze had agreed to have one of the funds purchase. As Pistell later described the terms of his oral agreement with Graze, the fund would receive approximately 1/3 of the profits. The

district court found only that Graze and Pistell had come to an understanding during August 1972 that IIT would invest in Vencap (A953a). The agreement between IIT and Vencap was signed at Nassau, Bahamas, on September 29, 1972, by Meissner on behalf of IIT and by Pistell for Vencap.

This agreement, which contained a copy of the Vencap resolutions defining the rights of the preference stock being purchased by IIT, was drafted in the first instance by IIT's lawyers, the New York law firm of Willkie Farr & Gallagher ("Willkie Farr"), who presented a draft to Vencap's lawyers for review. Some time after August, there was prepared a three-page memorandum briefly describing Vencap and the agreed-upon investment in it by one of Graze's funds. This memorandum is reproduced as Exhibit A to the district court's opinion, and was the sole basis for the district court's conclusion that plaintiffs were likely to establish a violation of the federal securities laws (A967a-70a). Although the district court made no finding that this document had been actually delivered to anyone representing IIT, the testimony at the hearing was that the document had been prepared in Nassau

at the offices of Carson, Lawson after consultation between Pistell and Murphy in Nassau pursuant to a request by IIT's counsel for a document summarizing the transaction (A667a-68a). Pistell had previously testified, in an entirely different context, that he believed that the memorandum had been sent to Graze in London (undoubtedly because it was so addressed) but had no definite information, and, in any event, said nothing at that time about where he thought it had been prepared, or where mailed from (A1814a-16a). At the hearing in this case, Pistell confirmed Murphy's testimony that the document had been prepared after consultation with Murphy in the Bahamas and recalled the additional detail that Vencap had to get stationery printed up so that Carson, Lawson could have the document typed on Vencap's letterhead (A700a).

The memorandum refers to an annexed copy of the August 31, 1972 resolution of Vencap which authorized the preference shares, and the agreement for the purchase of the shares incorporates by reference, as an Exhibit attached to it, the Vencap resolutions describing the preference stock and its rights. The preference shares can vote only on matters that affect their rights, and

are entitled to receive their dividends, if any are declared at all, in full before any dividends may be paid to the ordinary shares. These non-cumulative dividends are of two kinds: a 6% dividend and an additional dividend of up to one-third of the net earnings of Vencap after deduction of the initial 6% dividend. They are also redeemable at par plus 6% for the portion of the year of redemption (A1607a-09a).

The closing of the transaction took place on October 9, 1972 in the Bahamas. The funds were paid to Vencap through the Bahamas Commonwealth Bank and were transferred within a few days by Vencap to The Chase Manhattan Bank in London in order to obtain a higher Eurodollar interest rate (A528a-29a). The district court found that the $3,000,000 paid by IIT had come from the American National Bank and Trust Company of New Jersey, which had been a sub-custodian for some of IIT's United States securities (A960a). Although Pistell contends that the evidence does not support this finding, but rather that the funds were transferred directly from cash balances maintained in Luxembourg by IIT's main depository bank, nevertheless there is no question that the transfer

from American National Bank and Trust Company to the Bahamas, if it occurred, was neither caused by, known to, nor foreseeable by, Pistell or any of the other appellants.

Subsequent Events

Plaintiffs claimed that Pistell had wasted the assets of Vencap by making improvident investments and taking excessive salary and expenses. The district court made numerous findings of fact with respect to events taking place after the issuance of the preference stock to IIT, but did not conclude that the plaintiffs were likely to prevail in establishing those claims. The court's specific findings with respect to expenditures and disbursements by Pistell, moreover, do not include any indication of which items, if any, the district court concluded were excessive. Instead, the court found to be significant the fact that the three-page memorandum did not disclose some of the subsequent uses of some of the $3,000,000. These uses were: (a) a $590,000 secured loan indirectly from Vencap to Pistell and (b) investments by Vencap in "companies in which Pistell had a substantial personal interest" (A963a). Apparently, the

investments referred to by the district court are the options Vencap has to purchase shares in Chibex, Ltd., for those are the only investments of this kind mentioned by the court in its findings (A958a-59a).*

The Loan to Pistell. Around the summer of 1972 Pistell was in a tight cash position because of a substantial federal income tax liability. In January 1973 Vencap took steps to make a secured loan to Pistell in the amount of $590,000; when the loan was consummated in February 1973, some four months after IIT's investment in Vencap, most of the proceeds went to pay Pistell's tax liability. The loan was made indirectly through a Swiss bank and Intercapital for tax reasons, and Pistell posted security of shares in

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*Plaintiffs had initially attacked Vencap's investment, through Intervent, in certain oil and gas properties which had been purchased by Intervent from Flag-Redfern Oil Company, in which Pistell is a small stockholder. The evidence before the district court, however, showed that Vencap and Flag-Redfern were actually joint venturers in purchasing the properties, but Flag-Redfern made the entire purchase because Vencap's subsidiary, Intervent, had not yet been formed. When Intervent was formed, it purchased the properties from Flag-Redfern at Flag-Redfern's cost. In its findings, the district court made no reference to this transaction (A552a, 1927a, 1709-12a, PX 14-27A). In fact Intervent sold its interests a few months later at a gain, net of all expenses, of approximately $125,000, in April 1974.

Flag-Redfern Oil Corp. worth more than the principal amount of the loan, which bears interest of 9-1/2%. In addition, Pistell gave Vencap an option on 10% of the shares at his original cost, which was considerably below their then value. Two months later, in April 1973, Pistell testified freely about this transaction. At the hearing in this case, in response to a direct question from the court, Pistell testified that Graze knew about Pistell's tax problem before IIT invested in Vencap, and that he told Graze about the loan before making it. The district court did not find Pistell's testimony to have been inaccurate on these points but simply made no findings at all as to whether Pistell had told anything to Graze. Pistell's testimony about the value of the Flag-Redfern stock was not impeached. There was no suggestion that the loan was improper under Bahamian law (A707a-09a, 1414a, 1417a, 3988a, 580a-81a).

Vencap Investments in Chibex. Chibex is a Canadian gold mining corporation, the stock of which is listed on the Montreal Stock Exchange. At the time of the hearing Pistell was Chairman of the Board of Directors, and he and Blackman had a controlling interest in Chibex

through Conservative Capital Limited, a Bahamian holding company owned by Pistell and Blackman. In the Summer of 1972 Conservative Capital borrowed $1,000,000 from FOF Proprietary Funds Ltd., a Canadian investment company ("FOF Prop."), which it used to purchase 2,000,000 shares of Chibex from the issuer with the approval of the Quebec Securities Commission. The shares are pledged to FOF Prop. as collateral for the loan, and, in addition, FOF Prop. has an option to purchase one-quarter of those shares (500,000) at Conservative Capital's original cost of $.50 per share. At the time, Chibex had an inactive gold mine which required a substantial investment to re-open; the $1 million of new capital was used for this purpose. In November 1973, more than a year after IIT's investment in Vencap, Vencap lent Conservative Capital $75,000, through Intercapital. In return, besides interest, Vencap received an option to purchase 75,000 Chibex shares from Conservative Capital at $1.00 per share; if Vencap lent another $75,000 before August 1974, Vencap would receive an option for another 75,000 shares at $1.50 per share. Prior to commencement of plaintiffs' action, and even during the hearing before the court below, the

options were valuable.* These are the options referred to by the district court (A451a, A448a-453a, A729a-730a, A1481a-1482a, A1540a).

Relatively Minor, but Clearly Erroneous, Findings of Fact

In the course of its findings of fact, the district court made several findings which were simply mistakes and which appear to be, in the light of the court's own conclusions of law, legally irrelevant to its decision to issue the injunction and appoint the receiver. Nevertheless, even though the court did not make any findings of bad faith on the part of Pistell or any other defendant, some of these mistaken findings might be read as implying such a prejudicial conclusion, and therefore must be called to the attention of this court.

(1) As perhaps the most minor matter, the

* At the time plaintiffs commenced their action without advance notice to or demand upon defendants, they obtained a temporary restraining order and they made copies of their complaint and supporting papers available to the Wall Street Journal and various others. After a long press release appeared on the Dow Jones in the United States and in Canada, the price of Chibex shares plunged from $1.78 to $1.18, a decrease of nearly one-third in the Chibex equity. The immediate resulting loss in the equity of the Chibex shareholders, including Pistell and Blackman (through Conservative Capital), was nearly $4,000,000. (A 187a-189a, A 448a-453a, A 729a-730a).

court concluded that the defendant Blackman, who had not been served at the time of the hearing, had violated the securities laws in connection with IIT's October 1972 purchase of Vencap's preference shares (A964a). Elsewhere, however, the district court acknowledged that Blackman was not even associated with Vencap at the time that IIT purchased its shares, but became a shareholder only about six months later (A953a).

(2) The district court found that "Pistell and Blackman have each agreed to sell to the other for $5,000 their interest in Vencap in the event of the death or termination of employment of either." (A956a). The district court also appeared to rely upon this fact in evaluating the harm that would occur to Pistell in the event that an injunction was issued (A964a). In fact, the only basis for this conclusion is a document that shows quite clearly that the only shareholder of Vencap who was required to sell his shares in the event of death or termination was Blackman, not Pistell (A3977a-82a). The last page of this document reveals that the only person who signed as a "Holder" of Vencap shares, who was therefore obliged to sell, was Blackman. Plaintiffs counsel strongly contended during cross-examination that

Pistell was also bound as a holder (A808a-10a) but the document itself is simply not capable of such interpretation.

(3) The district court made a similar highly misleading finding that "in March 1973 Pistell (as well as Blackman) agreed to sell his interest in Vencap at cost to LeBlanc if and when requested to do so by LeBlanc." (A956a). The very testimony that established such an offer by Pistell (but not by Blackman) also revealed that Pistell had made the offer in the context of a possible global settlement that would be made between the management of the various IOS funds and all the claimants against those funds, including the Securities and Exchange Commission. (A1869a, 1790a-1803a, A810a-14a). Although plaintiffs challenged Pistell's assertion that he himself had not actually drafted the letter which made that proposal (as though that made any difference), they did not contest Pistell's account of why the offer was made. In any event, Pistell withdrew his offer after consulting with counsel.

(4) After listing amounts that had been paid by Vencap to Pistell, the district court then found as follows:

> " Prior to the formation of Vencap, Pistell earned a finder's fee of $150,000 in connection with the transfer of IIT money for financing a Vesco business deal in Costa Rica. Pistell testified before this Court in April, 1973 in another matter that in July, 1972 he transferred $100,000 of this amount to Vencap for startup costs and it was not a loan by him to Vencap. Thereafter in May, 1973 Vencap entered into an agreement with Pistell that retroactively characterized the July, 1972 investment as a loan."

It is true that in July, 1973 Pistell took $100,000 of his own and placed it in a bank account belonging to Vencap. It is also true that in May 1973, through a resolution of the board of directors of Vencap and a letter agreement signed by Blackman on behalf of Vencap, Vencap acknowledged in writing the fact that the $100,000 had belonged to Pistell personally. It is not true that (a) the May 1973 Vencap documents "retroactively characterized" the $100,000 as a loan (A1253a, 1260a); or (b) that Pistell had ever testified that the $100,000 "was not a loan by him to Vencap". Pistell's previous testimony, read to him during his cross-examination at the hearing below, shows some semantic misunderstanding between Pistell and his examiner over approximately $20 to $25 thousand of the $100 thousand fee (A770a-72a). But there has never

been any question that no one was ever misled into believing that the $100,000 belonged to Vencap, rather than to Pistell. A review of all Pistell's testimony on this issue simply provides no basis for any rational implication that Pistell was not being candid about the $100,000 (A1368a-70a, 1758a-60a, 768a-78a).

(5) The district court found that, according to Vencap's accountants, Pistell had received "compensation" of $356,640.62 from Vencap, broken down into $190,094.57 as salary and advances, and $162,546.05 for his house (and Vencap's office). But the district court also stated in the same paragraph that "Vencap has <u>also</u> paid more than $10,000 to Louise Pistell, Pistell's ex-wife, as alimony payments" and additional amounts to Pistell's current wife for telephone bills (A957a). In fact, however, the alimony payments were charged to Pistell personally by Vencap's accountants, and thus are <u>part</u> of the $356,640.62 mentioned above; and any telephone bills that were not charged to Pistell personally by the accountants were made for Vencap's business, even though they may have been placed from some one else's phone. At the hearing plaintiffs did not call the accountants as witnesses and never impeached Pistell's

deposition testimony that telephone bills were routinely reviewed and each call charged to whatever account was proper (e.g., Vencap, Pistell, Chibex) (A1848a).

More important, however, is the fact that, of the total amount "charged" to Pistell as "compensation", $100,000 represented how own money that Vencap was holding for him, the same $100,000 discussed in (4) above (A537a). The figure of $356,640.62 comes directly from a work-sheet of Vencap's accountants (A92a), which is simply a listing of all amounts paid out of Vencap's accounts that were not deemed to have a business purpose and were therefore charged to Pistell. As noted above, from at least as early as April 1973, when he testified for the SEC against Vesco, Pistell ingenuously acknowledged that there were a number of such charges because he was drawing against his own $100,000.

Consequently, the "compensation" paid to Pistell from Vencap's own funds amounts to only $256,640.62, of which $162,546.05 was a one-shot payment for the purchase and furnishing of his home, given

to compensate him for his loss on his apartment in New York, which he gave up to move to the Bahamas (A 703a-04a). Aside from the house, therefore, Pistell received only $90,094.57 as earnings. Over the 22 months from the start of Vencap through April 30, 1974 (the date of the accountant's work-sheet), this works out to approximately $4,100 per month or slightly less than his stated salary of $60,000 per year. That the accountants made an independent determination of whether an expense was personal or business was most eloquently and convincingly proved by Pistell's spontaneous reaction upon reviewing the Vencap ledger during his May 1974 deposition. His attention had just been called to a $20,000 payment to Vencap's accountants.

"The Witness: That is charged to me.

Mr. Taylor: That is an accounting fee.

The Witness: Why the hell is it charged to me?" (A 1863a).

The Source of the Evidence

Although most of the evidence was introduced by plaintiffs, by far most of it had been supplied willingly by appellants themselves in response to requests and subpoenas of the SEC. Indeed, Pistell's conduct throughout the period of the SEC investigation of the International Controls-IOS complex utterly belies the image of the shifty dealer in phantom corporations that plaintiffs have tried to portray, but rather has been entirely consistent with his past experience. Pistell's experience has not been primarily with "glamor" companies that die quietly after a few years of struggle. In his early years he participated in the initial public offering of such solidly-based operating companies as Capital Cities Television and Occidental Petroleum. More recently he was a founder of the Mary Carter Paint Company, and in 1972 he was a director and Chairman of the Executive Committee of Lincoln American Corporation, listed on the American Stock Exchange. Only a few weeks after having sold the preference shares to IIT Pistell was testifying in a SEC investigation into International Controls Corporation, without a hint of obstructionism (on November 1, 1972; A 3877a-3958a). Less than six months later he testified for five days on behalf of the

SEC in its action against Robert Vesco and others, during which he disclosed all the information which the district court has now found to be a violation of the securities laws. Vencap's then attorneys, Havens Wandless, continually provided information to the SEC, and Pistell himself testified for two days as a witness in discovery proceedings just weeks before this action was commenced (May 6 and 7, 1974; A 1660a-1868a). During all this time no representative of IIT had made any inquiries about Vencap, much less complaints, even though the attorneys for plaintiffs were sitting at his May 1974 deposition, during which Pistell and his attorneys disgorged practically all the records of Vencap at the request of the SEC, with never a complaint, a cavil or even a stall.

ARGUMENT

POINT I

THE DISTRICT COURT'S FINDINGS AND THE EVIDENCE SUPPORTING THEM DEMONSTRATE THE ABSENCE OF FEDERAL SECURITIES LAW JURISDICTION

A. The Jurisdictional Statutes of the Federal Securities Laws

Plaintiffs claimed, and the district court found, subject-matter jurisdiction under the Securities Act and the Exchange Act. The jurisdictional sections of those acts, co-extensive for present purposes, give the United States district courts jurisdiction, in essence, "to enforce any liability or duty created by this title." 15 U.S.C. §§77v, 78aa. A finding of jurisdiction over a particular transaction, then, implies that the respective duties and rights of the parties to that transaction will be those created by the United States Congress and the Securities and Exchange Commission. This consequence of a finding that subject-matter jurisdiction exists must always be kept in mind when deciding whether to extend the federal court's power over a securities transaction that is foreign in some of its aspects.

B. This Transaction Is Not Embraced By Any Exception To The Presumption Against Extra-Territorial Application

The facts in this case - either as alleged by plaintiffs, as found by the district court or as justified by the evidence - fall several steps beyond both the holding and the rationale of this Court's most recent decisions explaining the territorial scope of the federal securities statutes. As the district court found the facts after an extensive (albeit impromptu) evidentiary hearing, inquiry into the applicable law most appropriately starts with this Court's statement of only two years ago, in Leasco Data Processing Equipt. Corp. v. Maxwell, 468 F.2d 1326, 1334 (2d Cir. 1972) ("Leasco"):

> "When no fraud has been practiced in this country and the purchase or sale has not been made here, we would be hard pressed to find justification for going beyond Schoenbaum [v. Firstbrook, 405 F.2d 200 (2d Cir. 1968)]."

Since there was no "fraud" (however broadly defined) practiced in the United States* and the purchase of the

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*Neither the complaint nor plaintiffs' contentions indicated that there would ever be any evidence of misrepresentation or misleading statements in the United States, or, indeed, of any substantive communications at all.

Vencap shares took place (both contract signing and closing) in the Bahamas, it remains only to examine the Schoenbaum decision and seek a justification for extending it if that holding does not govern these facts. As this brief will demonstrate, neither the Schoenbaum holding nor any basic principles enunciated in either Schoenbaum or Leasco suggest a justification for applying United States law to a foreign transfer of foreign securities between foreign corporations where all significant communications - both formal and informal - took place, quite naturally, outside the United States.

Schoenbaum held that section 10(b) of the Exchange Act governed a transaction in securities of a foreign corporation listed on an American securities exchange when the effect of the alleged violation was detrimental to that listed corporation. This Court expressed its holding in the following words:

> "We hold that the district court has subject-matter jurisdiction over violations of the Securities Exchange Act although the transactions which are alleged to violate the Act take place outside the United States, at least when the transactions involve stock listed on a national securities exchange, and are detrimental to the interests of American investors." 405 F.2d at 208.

Doubtless no one will deny that, at the very least, the district court's opinion herein is one "going beyond Schoenbaum." Far from being "listed on a national securities exchange," IIT's shares had been barred for years from the United States market, and the Vencap shares that were transferred have never been traded here. Thus, neither of the criteria of Schoenbaum ((a) exchange listing of the transferred shares, and (b) detrimental effect to American investors) are met, and in Leasco this Court strongly implied that both must be. Even where a listed American corporation, with its presumed preponderance of U. S. investors, was victimized by purchases of foreign and unlisted securities outside the United States, "we would entertain most serious doubt whether, despite [contrary precedent in another field of law]..., and Schoenbaum, §10(b) would be applicable ...." Leasco, supra, 468 F.2d at 1334. Thus, the present case is at least two steps "beyond Schoenbaum."

As the first quote above, from Leasco, indicates, Leasco held §10(b) applicable to a foreign securities transaction of a foreign issuer, not traded here, when the following additional factors were present: (a) substantial misrepresentations in the United States (b) to a

United States victim (in that case, an American corporation listed on the New York Stock Exchange). In an opinion written with great precision and extreme care, this Court made it plain that the Leasco fact situation presented a borderline example, one that was resolved primarily by inquiring into the purposes of the statutes.

> "[W]e must ask ourselves whether, if Congress had thought about the point, it would not have wished to protect an American investor if a foreigner comes to the United States and fraudulently induces him to purchase foreign securities abroad-a purpose which its words can fairly be held to embrace." Leasco, supra, 468 F.2d at 1337.

This Court answered the question with these rather cautious words:

> "...we think it tips the scales in favor of applicability when substantial misrepresentations were made in the United States." Ibid. (emphasis supplied).

As the context indicates, this Court was also assuming that the "substantial misrepresentations" were made to a United States national or resident.

Again, the present case is several steps beyond the Leasco borderline situation: (a) there were no misrepresentations (much less "substantial" ones) in the

United States, and (b) plaintiff trust is not American.* When Schoenbaum and Leasco are read together it appears that the securities laws are designed to protect two central interests of this country: (a) persons within its borders; (b) markets within its borders. Even so, not every transaction that merely touches one of these interests will be subject to the securities laws. For example, Leasco made it plain that merely talking to a United States resident here about a security would not invoke the Exchange Act; the talk must include a substantial misrepresentation. This single transaction in the Bahamas, induced through conversations there and in London, did not even touch, much less substantially affect, either of the United States interests protected by the securities laws.

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*The district court's finding that IIT had United States residents or citizens as beneficiaries is quite simply unjustified, as is more fully explained by the brief submitted on behalf of appellants Murphy, Taylor and Havens, Wandless, the arguments in which we respectfully ask leave to incorporate by reference. Even if plaintiffs' claims are correct, however, and can be proved at trial, IIT appears to be about "99 and 44/100 per cent" foreign.

POINT II

THERE IS NO NON-SECURITIES BASIS FOR FEDERAL COURT JURISDICTION

Inasmuch as their brief is devoted solely to the jurisdictional issue, Pistell respectfully refers to the argument on this point in the brief of appellants Murphy, Taylor and Havens, Wandless. We note only that there is no diversity jurisdiction when there are aliens on both sides, that the specific jurisdictional statute controls the general, that the law of nations has nothing to do with this case, and that the N.Y.C.P.L.R. §302 relates only to personal jurisdiction.

POINT III

THE DISTRICT COURT'S FINDING OF LIKELY SUCCESS ON THE MERITS IS NOT SUPPORTED BY THE EVIDENCE

Despite the detail in the district court's findings of fact, nevertheless, the opinion becomes vague at just those important points where precision and clarity are imperative. Judge Stewart found that plaintiffs were likely to succeed in establishing only their federal securities law claim, in that "in connection with the

purchase of the non-voting Vencap securities, the defendants Pistell, Blackman and Vencap" engaged in deceptive practices (A964a). But in its earlier findings upon which this conclusion was based, the district court had found only that a particular document was false and misleading, without ever having found that the supposed short-comings of the document had any effect (A962a).* This is not merely a question of a minor inadvertent omission as, for example, might be the case where the parties had raised no serious question on issues of materiality and reliance. Instead, not only were these issues sharply contested, but the evidence on them was almost entirely in favor of the defendants, and unimpeached, not to say ignored, by plaintiffs. Beyond its plain omission of the issues of reliance and materiality, however, the opinion's analysis of the supposedly misleading document is so narrowly focused as to have overlooked critical portions of the very documents being analyzed, to say nothing of the larger context in which the documents were used.

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*Of course, to the extent that jurisdiction is missing, or doubtful, the likelihood of success is correspondingly diminished.

Likelihood of Plaintiffs' Success

The district court found that plaintiffs "have ... demonstrated a likelihood that they will prevail on the merits" of their securities fraud claims (a964a). It is axiomatic that there are five elements to a claim of securities fraud: (1) inaccurate statements of some sort* (2) that are material, (3) made with the requisite intent,** and (4) relied upon (5) to plaintiff's detriment. In making specific findings, however, the district court found only that plaintiffs "will probably succeed in showing that the memorandum was false and misleading under the circumstances" (A962a) and that "it is only reasonable to assume that Pistell knew" of one of the falsities (Ibid.). Thus, the district court addressed itself to items (1) and (3) of the necessary elements, and there was no dispute about item (5), for IIT had paid for the Vencap shares. Discussion begins most appropriately with its findings of inaccuracy, for the other

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*Included are not only falsehoods and material omissions but also a deceptive scheme.

**Generally, knowledge of the falsity or omitted fact, or a reckless disregard for the truth. Lanza v. Drexel & Co., 479 F.2d 1277, 1305 (2d Cir. 1973).

elements must be considered in light of the specific shortcomings found in the memorandum.

Claimed Deficiencies Of The Three-Page Memorandum

The district court's findings of falsities and omissions in the memorandum are set out in one short section of its opinion, from the beginning of page A962a of the Joint Appendix to the end of the last full paragraph of page A963a. The district court tentatively found that the memorandum contained (a) two misleading statements and (b) four "substantial and material" omissions. The misleading statements are described in the first paragraph on page A962a and the beginning of the second paragraph on that page.

The "Misleading Statements"

In what way were the statements misleading? The district court found that the memo's statements were inconsistent with the terms of the actual signed agreement between Vencap and IIT, an agreement not only signed (and presumably read) by IIT's representative, but also read by IIT's Bahamian and American counsel, who had, in fact, prepared the initial draft of those terms. There is thus no other basis for a finding of inaccuracy beyond

the supposed inconsistency of two documents, both delivered to the purchaser, both read by purchaser's counsel. Under these circumstances it is difficult to understand how the statements in the memo, even if inaccurate, could have helped to cause IIT to consummate the purchase. Not surprisingly, the district court did not make any finding that there was such a causal connection.

"The "Material Omissions"

Of the four material omissions, the first is a failure to disclose a particular provision of the agreement, and so this finding has the same infirmity as the findings of misleading statements: that is, the court found that there was a "significant and material omission" in one document because it failed to say something that was contained in another document that was delivered to the same person at about the same time. The three remaining omitted "facts" break down into two groups: (a) a then-existing fact, Pistell's income tax liability, and (b) two future events: Pistell's collateralized borrowing of $590,000 indirectly from Vencap and Vencap's future investments in companies in which Pistell had a substantial personal interest. Inasmuch as Pistell told

Graze about his intention to borrow the money (A708a-09a), we are left with a non-disclosure of future investments without any finding by the district court that Pistell had any such intention at the time IIT purchased the Vencap shares. Indeed, such a finding would be unsupportable in light of the fact that the Vencap loan to Conservative Capital and the acquisition of the Chibex options did not occur until November 1973, more than a full year after the memo was prepared. See page 23, supra.*

Reliance and Materiality

The district court evidently believed that by finding the memorandum to have been intended as part of the inducement leading IIT to make the purchase, the reliance issue had been resolved. Quite likely it reached this erroneous conclusion because plaintiffs contended that the memo served only as a cover to a conspiracy,

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*The district court also found that Vencap is obliged to purchase Chibex shares from Fund of Funds upon three days' notice (A958a). This finding is apparently based upon a document dated August 29, 1972 (A1659a), which looks as though it has such an effect, but which Pistell testified had been cancelled. In any event, since the document was negotiated with Graze, IIT knew of its existence when it purchased the Vencap shares.

while Pistell and Murphy testified that the memo was viewed by IIT as a mere formality of little significance and was treated as such by Vencap. Both sides, then, were arguing that the memo had actually induced no one to do anything, and when, in colloquy, the court accepted defendants' contention that it was not a "selling document" there was no further exploration of alternative ways of viewing it.

> "MR. ORAM [defendants' counsel]: It's not what we think of in U.S. securities parlance as a selling document. Mr. Murphy testified it was a memorialization.
>
> "THE COURT: That is right and I don't know how much significance to attach to it. If it was a selling document, I think I would be a little more concerned about it than I am, but obviously it wasn't a selling document." (A911a).

Consequently, when the court reversed its position and rejected the "memorialization" characterization, it apparently felt obliged to conclude further that the memo must be regarded as a "selling document" "in U.S. securities parlance." Its opinion shows quite clearly that after the district court found the memo to have been "part" of the inducement, it neglected to inquire whether it might have been, nevertheless, an insignificant part.

The Inter-Relationship Among Inaccuracy, Materiality and Reliance

In short, the district court failed even to consider the possibility that - as the evidence clearly shows - the transaction was essentially based upon personal contacts and personal reputation, negotiated between sophisticated businessmen, where Graze's evaluation of Pistell personally was infinitely more important than any summary of information that could have been contained in three pages. Instead, it treated the "three-page memorandum" as though it were a statutory prospectus or "private placement memorandum" in which any omission or inconsistency is to be viewed with suspicion.

The district court failed altogether to note that (1) the memorandum specifically mentioned the one-third of earnings limitation on the dividend, (2) the memorandum specifically referred to the "annexed" copy of the resolution describing the rights of the preferential shares, and alluded to those shares as "redeemable" (A967a, 969a), (3) Bahamian law, according to plaintiffs' own expert, probably would prevent any abuse by management, such as building up earnings without a dividend and then redeeming the shares (A385a) and (4), perhaps most

important, Pistell's long-range self interest in not destroying his reputation in the financial community, built up over decades and probably his most important asset, would be seen by IIT as the most powerful deterrent to any attempt by Pistell to renege on the basic agreement he had negotiated face-to-face with Graze. As has been noted above (p. 31), Pistell had been associated with many substantial companies in high-level positions for many years; he had not been a fly-by-night promoter.

In light of the minimal function which the memorandum as a whole played in the transaction, therefore, there is no basis for holding that it ought to have been any more precise or detailed than it was, or that even a flat-out misstatement would have had a material effect if subsequently corrected even orally, much less in writing.

POINT IV

EVEN ASSUMING THAT PLAINTIFFS HAD ESTABLISHED LIKELY SUCCESS ON THE MERITS, THEY FAILED UTTERLY TO ESTABLISH THE NEED FOR INJUNCTIVE RELIEF

Even assuming, for the sake of argument, that plaintiffs had established the likelihood of success on

their federal securities law claims, nevertheless the preliminary injunction is quite unjustified on the basis of the evidentiary record before the district court. Both the district court's findings, and the evidence as construed most favorably to the plaintiffs, reveal the following fundamental defects:

(1) The preliminary injunction radically alters the status quo ante, in violation of the normal function of the preliminary injunction;

(2) Plaintiffs neither claimed nor proved the possibility of immediate irreparable harm absent a preliminary injunction.

It must be remembered that the injunction entered here did not merely forbid Vencap or Pistell from making certain expenditures or undertaking certain courses of conduct; it did not merely set limits on the amount of money that might be expended by Vencap or the other corporate defendants; it did not merely require Vencap or Pistell to give periodic accountings. Instead, it transferred complete custody and control over all the assets of the three corporate defendants to an independent re-

ceiver, who must obtain the approval of the court before making any but the most trivial expenditures. Not only does the injunction go far beyond the simple maintenance of the status quo pending a final determination of the merits (which is, after all, "the purpose of a preliminary injunction", Checker Motors Corp. v. Chrysler Corp., 405 F.2d 319, 323 (2d Cir. 1969)), but was actually entered in the face of the district court's finding of probable success on the merits only with respect to the securities law claims, as to which plaintiffs' own complaint asked only for money damages, not for any form of injunction (A27a, §§2,3).

It is, of course, axiomatic that equitable relief will not be granted where an adequate remedy at law exists. The district judge appeared to recognize this rule by finding that plaintiffs would be irreparably harmed absent an injunction because "if the continued outflow of money is allowed to continue, there will be no assets left to satisfy a final judgment against defendants" (A964a). This statement fails utterly to take account of the possibility that defendants other than the corporate defendants would be able to satisfy a judgment.

This defect is particularly striking in view not only of the total failure of plaintiffs to submit

evidence as to Pistell's financial resources, but also of the fact that plaintiffs argued out of both sides of their mouths. When it was to their advantage they contended that Pistell would not be hurt by the injunction because he was a man of very substantial means (A840a). A little later, however, when trying to show that judgment would not be satisfied, they argued that "this record shows that Mr. Pistell is virtually judgment proof" (A879a). In support of this contention they cited Pistell's tax liability of two years previous. Plaintiffs deliberately failed to offer evidence on the crucial issue of immediate irreparable harm. This Court has very recently emphasized that even with the strongest possible showing of eventual success, an injunction will not be issued on a claim for money only unless plaintiff assumes his burden of showing uncollectibility. In SCM v. Xerox, Dkt. No. 74-1585 (2d Cir., November 4, 1974) this Court denied plaintiff a hearing on a preliminary injunction motion because of its failure to specify in advance its irreparable injury, even though, for purposes of defendant's motion in opposition, liability was conceded.

These plaintiffs have had their hearing, they specified uncollectibility as their irreparable injury,

and they avoided even trying to prove it.

CONCLUSION

Because of the lack of jurisdiction, and the failure to prove deception and irreparable harm, the injunction should be dissolved and the complaint dismissed upon remand.

Respectfully submitted,

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I certify that I served two copies of the within brief upon the other parties to this action by depositing two true copies, securely wrapped with first class postage affixed, in the Grand Central Post Office, New York, New York, on January 13, 1975, addressed as follows:

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